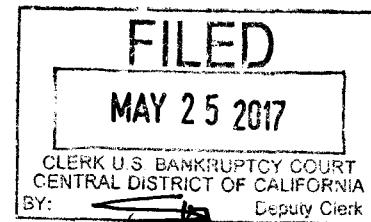


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7 C1R DISTRIBUTION, LLC and
8 RASCAL VIDEO, LLC

9
10 **UNITED STATES BANKRUPTCY COURT**
11
12 **CENTRAL DISTRICT OF CALIFORNIA**
13
14 **LOS ANGELES DIVISION**

15
16 In re
17 JEFFERSON HOWARD HITCHCOCK,
18 Debtor.

19
20 SAM S. LESLIE, as Chapter 7 Trustee of
21 the Estate of Jefferson Howard
22 Hitchcock,

23 Plaintiff,

24 vs.

25 ROBERT NOVINGER; an individual;
26 C1R DISTRIBUTION, LLC, a
California limited liability company;
C1R, Inc., a California corporation;
RASCAL VIDEO, LLC, a California
limited liability company,

27 Defendants.

28 CHAPTER 7 **FILED BY FAX**

Case No. 2:15-bk-16468-RK

ADV. No. 2:17-ap-01246-RK

**DEFENDANTS' NOTICE OF
MOTION AND MOTION TO
DISMISS COMPLAINT PURSUANT
TO RULE 12(b)(6) OF THE
FEDERAL RULES OF CIVIL
PROCEDURE; MEMORANDUM OF
POINTS AND AUTHORITIES IN
SUPPORT THEREOF**

Hearing:

Date: July 11, 2017
Time: 3:30 p.m.
Location: 255 East Temple St.
Courtroom 1675
Los Angeles, CA 90012

Judge: Hon. Robert N. Kwan

1 **TO THE HONORABLE ROBERT N. KWAN, U.S. BANKRUPTCY JUDGE,**
2 **THE PLAINTIFF, THE TRUSTEE, THE OFFICE OF THE UNITED STATES**
3 **TRUSTEE, ALL OTHER INTERESTED PARTIES, AND THEIR COUNSEL**
4 **OF RECORD:**

5 **PLEASE TAKE NOTICE** that on July 11, 2017, at 3:30 p.m. before the
6 Honorable Judge Robert N. Kwan in Courtroom 1675 of the United States
7 Bankruptcy Court located at 255 East Temple Street, Los Angeles, California, Robert
8 Novinger, C1R Distribution, LLC, C1R, Inc., and Rascal Video, LLC, Defendants in
9 the above-referenced adversary proceeding, will and hereby do move for entry of an
10 order dismissing the Plaintiff's Complaint with prejudice and without leave to amend.

11 Defendants bring this Motion, by and through their counsel of record on the
12 grounds that each claim asserted in the Trustee's Complaint fails to state a claim upon
13 which relief may be granted. Specifically, the Motion is made on the following
14 grounds:

15 1. The claims asserted in the Complaint belong to Hot Box Grafix, Inc., a
16 California corporation of which Debtor is the sole shareholder. Hot Box Grafix, Inc.
17 has had its corporate status suspended by the Franchise Tax Board and as such is
18 unable to prosecute or defend claims.

19 2. Each claim asserted in the Complaint is based on an allegation that Hot
20 Box is entitled to property of C1R Distribution, LLC to which it is not, in fact,
21 entitled under the operating agreement or applicable law.

22 This Motion is brought pursuant to Federal Rules of Civil Procedure, Rule
23 12(b)(6) made applicable by Federal Rules of Bankruptcy Procedure, Rule 7012;
24 Rule 9013-1 of the Local Bankruptcy Rules, and other applicable statutory and case
25 law as the facts of the matter may present. This Motion is based on this Notice of
26 Motion and Motion, the Memorandum of Points and Authorities attached hereto; the
27 Declaration of Paul Papile and Request for Judicial Notice filed concurrently
28 herewith; all pleadings, documents and records on file with this Court, upon oral

1 argument made at the time of hearing, and as such other matters as the Court may
2 properly consider at or before the hearing.

3 PLEASE TAKE FURTHER NOTICE that pursuant to Local Bankruptcy
4 Rules, Rule 9013-1(f), any interested party wishing to oppose or respond to this
5 Motion must file and serve the response on the moving party upon the attorney listed
6 above and the Office of the United States Trustee not later than 14 days before the
7 designated date for hearing. Failure to file and serve a timely written opposition may
8 be deemed to constitute consent to the relief requested in the Motion.

9
10 Dated: May 25, 2017

Respectfully submitted,

11
12 **LAW OFFICE OF S. CHRISTOPHER WINTER**

13 By: 

14 S. Christopher Winter
15 Attorney for Defendants
16 C1R DISTRIBUTION, LLC,
17 RASCAL VIDEO, LLC, C1R, INC.,
18 ROBERT NOVINGER

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1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 **INTRODUCTION AND FACTUAL BACKGROUND**

3 Prior to filing bankruptcy, Jefferson Hitchcock (“Debtor”) was the sole
4 shareholder of Hot Box Grafix, Inc. (“Hot Box”), a California corporation.
5 (Complaint, ¶ 11). Hot Box, in turn, was a member of defendant C1R Distribution,
6 LLC (incorrectly sued as “C1R Distributions”) (“C1R Distribution” or the “LLC”).
7 (*Id.*). Since approximately 2014, C1R Distribution’s main asset has been two
8 accounts receivable from defendant Rascal Video, LLC in the total amount of
9 \$1,220,311.90 as of December 31, 2014. (*Id.* at ¶ 17).

10 Hot Box and the other members of C1R Distribution are parties to an operating
11 agreement (the “Operating Agreement”). (*Id.* at ¶ 37). The Operating Agreement
12 provides, among other things, that:

- 13 • Legal title to all LLC assets shall be held in the name of the LLC, and
14 members have no right, title or interest in or to any LLC property nor
15 any right to partition LLC property (§1.2);
- 16 • No member shall have the right to withdraw any part of his capital
17 contribution or receive any return on any portion of his capital
18 contribution (§6.7);
- 19 • No member shall have priority over any other member, either as to the
20 return of capital contribution or as to net income, net losses, or
21 distributions (§6.7);
- 22 • Members shall distribute Distributable Cash at such time and in such
23 amounts as may be determined in the sole discretion of the Members.
24 (§7.1);
- 25 • “Distributable Cash” means, with respect to the Company for a period of
26 time, all funds of the Company which, at the discretion of the Members,
27 are available for distribution to Members after provision has been made
28 for payment of all operating expenses and of all outstanding and unpaid

1 current obligations of the Company as of such time, and for such
2 reserves as the members deem appropriate or necessary. (§7.1);
3 • Except as provided by the Operating Agreement, no Member shall at any
4 time retire or withdraw from the Company or withdraw any amount out
5 of his capital account. (§8.1).

6 Jefferson Hitchcock filed a voluntary Chapter 7 petition on April 24, 2015. (*Id.*
7 at ¶ 18) The Plaintiff, Sam Leslie, is the Chapter 7 bankruptcy trustee for the estate
8 of the Debtor. Hot Box is currently suspended by the Franchise Tax Board.

9 On April 25, 2017, the Trustee filed an adversary complaint against C1R, Inc.,
10 majority owner and manager of C1R Distribution, Robert Novinger, one of the
11 shareholders of C1R, Inc., and Rascal Video, LLC, a third party of which Novinger is
12 a manager (the “Complaint”). Although the Complaint asserts five causes of action,
13 each claim is based on the same set of three core factual allegations:

14 1. C1R Distribution did not distribute revenue from the Rascal loans to Hot
15 Box,
16 2. C1R Distribution did not pay Hot Box its capital account,
17 3. C1R Distribution did not pay Hot Box twenty percent of the outstanding
18 balance of the loans due from Rascal.

19 Because each of the Trustee’s claims is based on these same facts, they all fail
20 for more or less the same reason: The acts that the Trustee demands would constitute
21 a breach of the Operating Agreement for which the managers who performed them
22 would be personally liable. Hot Box is not entitled to its capital account, or to
23 amounts owed to C1R Distribution, or to receive distributions in priority to other
24 members. By entering into the Operating Agreement, Hot Box agreed and consented
25 to these terms.

26 In addition, even if the Complaint did state viable claims, those claims belong
27 to Hot Box, not the Debtor, and cannot be asserted while Hot Box’s corporate status
28 is suspended.

1 The Complaint should be dismissed in its entirety, with prejudice.

2 **LEGAL STANDARD**

3 Rule 12(b)(6) authorizes the court, upon motion of the defendant, to dismiss a
4 complaint for failure to state a claim upon which relief can be granted. Fed. R. Civ. P.
5 12(b)(6): "The purpose of Fed. R. Civ. P. 12(b)(6) is to enable defendants to
6 challenge the legal sufficiency of complaints without subjecting themselves to
7 discovery." *Rutman Wine Co. v. E.&J. Gallo Winery*, 829 F.2d 729, 738 (9th Cir.
8 1987). Rule 12(b)(6) is applicable to adversary proceedings by FRBP 7012(b).

9 Under Rule 8(a), a complaint must contain "a short and plain statement of the
10 claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). Rule 8(a)
11 is applicable to adversary proceedings by FRBP 7008(a). "[T]he pleading standard
12 Rule 8 announces does not require 'detailed factual allegations,' but it demands more
13 than an unadorned, the-defendant-unlawfully-harmed-me accusation." *Ashcroft v.*
14 *Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S.
15 554, 555 (2007)). "[A] complaint must contain sufficient factual matter, accepted as
16 true, to 'state a claim to relief that is plausible on its face.'" *Iqbal*, 556 U.S. at 678
17 (quoting *Twombly*, 550 U.S. at 570). "A claim has facial plausibility when the
18 plaintiff pleads factual content that allows the court to draw the reasonable inference
19 that the defendant is liable for the misconduct alleged." *Iqbal*, 556 U.S. at 678
20 (quoting *Twombly*, 550 U.S. at 556). "[A] complaint [that] pleads facts that are
21 'merely consistent with' a defendant's liability . . . 'stops short of the line between
22 possibility and plausibility of entitlement to relief.'" *Iqbal*, 556 U.S. at 678 (quoting
23 *Twombly*, 550 U.S. at 557).

24 The trial court need not accept as true conclusory allegations in a complaint, or
25 legal characterizations cast in the form of factual allegations. *Twombly*, 550 U.S. at
26 555-56. A Rule 12(b)(6) dismissal may be based on either the lack of a cognizable
27 legal theory, or the absence of sufficient facts alleged under a cognizable legal theory.
28 *Johnson v. Riverside Healthcare Sys.*, 534 F.3d 1116, 1121 (9th Cir. 2008). A claim

1 cannot be plausible when it has no legal basis.

2 "In deciding Rule 12(b)(6) motions, courts are not strictly limited to the four
3 corners of complaints." *Outdoor Cent., Inc. v. GreatLodge.com, Inc.*, 643 F.3d 1115,
4 1120 (8th Cir. 2011). Courts may consider "matters incorporated by reference or
5 integral to the claim, items subject to judicial notice, matters of public record, orders,
6 items appearing in the record of the case, and exhibits attached to the complaint
7 whose authenticity is unquestioned; these items may be considered by the [court]
8 without converting the motion into one for summary judgment." *Wright & Miller,*
9 *Federal Practice and Procedure: Civil* 3d § 1357, at 376 (2004). See, e.g., *U.S. v.*
10 *Ritchie*, 342 F.3d 903, 908 (9th Cir. 2003) ("A court may . . . consider certain
11 materials — documents attached to the complaint, documents incorporated by
12 reference into the complaint, or matters of judicial notice — without converting the
13 motion to dismiss into a motion for summary judgment"); *Sears, Roebuck & Co. v.*
14 *Metropolitan Engravers, Ltd.*, 245 F.2d 67, 70 (9th Cir. 1956) ("[J]udicial notice may
15 be taken of a fact to show that a complaint does not state a cause of action."); *Branch*
16 *v. Tunnell*, 14 F.3d 449, 454 (9th Cir. 1994) ("[W]e hold that documents whose
17 contents are alleged in the complaint and whose authenticity no party questions, but
18 which are not physically attached to the pleading, may be considered in ruling on a
19 Rule 12(b)(6) motion to dismiss."), cert. denied, 512 U.S. 1219 (1994); *Barapind v.*
20 *Reno*, 72 F.Supp.2d 1132, 1141 (E.D. Cal. 1999) ("Matters of public record may be
21 considered, including pleadings, orders, and other papers filed with the court or
22 records of administrative bodies."); *Roe v. Unocal Corp.*, 70 F.Supp.2d 1073, 1075
23 (C.D. Cal. 1999) ("[E]ven if a document is neither submitted with the complaint nor
24 explicitly referred to in the complaint, the . . . court may consider the document in
25 ruling on a motion to dismiss so long as the complaint necessarily relies on the
26 document and the document's authenticity is not contested."); *International Audiotext*
27 *Network v. Am. Tel. & Tel. Co.*, 62 F.3d 69, 72 (2d Cir. 1995) (considering an
28 agreement that was not specifically incorporated into the complaint because the

1 complaint "relies heavily upon its terms and effect" such that the agreement is
2 "integral" to the complaint).

3 Here, the Operating Agreement is attached as Exhibit C to the Complaint. C1R
4 Distribution's tax returns for 2013, 2014 and 2015 are not attached to the Complaint,
5 but are explicitly referred to and relied on. The Court may therefore consider the
6 Operating Agreement and the tax returns without converting this motion to dismiss
7 into a motion for summary judgment.

8 **ARGUMENT**

9 **A. The Complaint must be dismissed because Hot Box Grafix, Inc. is a
10 suspended corporation that lacks the capacity to sue, and the
11 Trustee cannot pursue claims on its behalf.**

12 Hot Box, not the Debtor, is a member of defendant C1R Distribution.
13 (Complaint at ¶ 11). The Debtor is the sole owner of Hot Box. (*Id.*). Hot Box, not
14 the Debtor, is a party to the C1R Distribution Operating Agreement. (*Id.* ¶ 11). The
15 factual allegations upon which the claims in the Complaint are based all relate to
16 duties allegedly owed to Hot Box, not the Debtor: (i) "denying Hot Box
17 distributions;" (*see id.* at ¶¶ 16, 17, 19, 20, 26, 31, 38, 42, 49); (ii) failing to pay Hot
18 Box its capital *account* (*see id.* at 21, 26, 31, 38, 42, 49, 52); and (iii) failing to pay to
19 Hot Box twenty percent of the outstanding balance of loans due from defendant
20 Rascal (*see id.* at ¶¶ 26, 31, 38, 42). Other than various conclusory allegations of
21 malfeasance (e.g., "engaging in conduct that constitutes gross negligence, reckless
22 behavior, intentional misconduct, and knowing violation of the law") (*id.* at ¶ 26),
23 these constitute the entirety of the operative factual allegations underlying the
24 complaint. There is no wrongdoing specifically alleged in the Complaint other than
25 denying Hot Box distributions, failing to pay Hot Box its capital account, and failing
26 to pay Hot Box twenty percent of the outstanding balance of loans due from Rascal.

27 Under the Bankruptcy Code, the trustee stands in the shoes of the debtor and
28 has standing to bring any suit that the debtor could have instituted had she not filed

1 for bankruptcy. *Smith v. Arthur Andersen LLP*, 421 F.3d 989, 1002 (9th Cir. 2005),
2 citing *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n. 9 (1983). The
3 trustee is the representative of the bankruptcy estate and has the right to "collect and
4 reduce to money the property of the estate for which such trustee serves." *See* 11
5 U.S.C. § 704(a)(1). The "property of the estate" includes "all legal and equitable
6 interests of the debtor in property as of the commencement of the case," 11 U.S.C. §
7 541 (a)(1), including the debtor's causes of action.

8 The Trustee thus stands in the shoes of the Debtor, Jefferson Hitchcock, and
9 can bring any claims that the Debtor could have brought. The Trustee does *not* stand
10 in the shoes of Hot Box itself, but in those of its sole shareholder, the Debtor. This
11 distinction is significant, because Hot Box does not have the capacity to bring or
12 defend any litigation, having been suspended by the Franchise Tax Board for non-
13 payment of taxes. (*See Request for Judicial Notice* ("RJN") filed concurrently
14 herewith).

15 A domestic corporation whose powers have been suspended because it failed to
16 pay taxes or file tax returns lacks legal capacity to sue during its suspension. (Rev. &
17 Tax. Code, §§ 23301, 23301.5; V & P, *supra*, 212 Cal.App.4th at p. 132.) In order to
18 restore its corporate status and, consequently, its ability to prosecute claims, the
19 suspended corporation must pay all taxes, penalties, and other amounts owed, file an
20 application for relief, and obtain a certificate of revivor from the Franchise Tax
21 Board. (Rev. & Tax. Code, § 23305.)

22 The assertion that a plaintiff lacks capacity to sue is a "plea in abatement,"
23 which challenges the "place, mode, or time of asserting" a claim as opposed to its
24 merits. (*V & P Trading Co., Inc. v. United Charter, LLC* (2012) 212 Cal.App.4th
25 126, 133 (V & P), citations omitted.) A plea in abatement ordinarily results only in a
26 stay of the action until the basis for abatement is removed. (*City of Santa Clara
v. Escobar*, 244 Cal.App.4th 555 (2016) (*Santa Clara*); *United Medical Management
Ltd. v. Gatto*, 49 Cal.App.4th 1732, 1740 (1996) (*United Medical*).) However, a

1 court is entitled to dismiss the action without prejudice if the plaintiff is unable to
2 remedy the defect. (*United Medical*, *supra*, 49 Cal.App.4th at p. 1740.)

3 When a plaintiff acquires a claim from a corporation that itself lacked capacity
4 to sue under section 2203, the plaintiff effectively takes upon itself that same lack of
5 capacity. (See, e.g., *Cal-Western Business Services, Inc. v. Corning Capital Group*,
6 221 Cal.App.4th 304, 311 (2013) (*Cal-Western*) [when a plaintiff is assigned a cause
7 of action, “[t]he assignee ‘stands in the shoes’ of the assignor, taking his rights and
8 remedies, subject to any defenses which the obligor has against the assignor prior to
9 notice of the assignment” (italics omitted)]; see also *Thorner v. Selective Cam
Transmission Co.* 180 Cal.App.2d 89, 93 (1960) (*Thorner*).)

10 In *Cal-Western*, a corporation whose powers were suspended for failure to pay
11 taxes assigned its right to enforce a judgment to the plaintiff, who filed suit on the
12 judgment four years later. (*Cal-Western*, *supra*, 221 Cal.App.4th at 306.) The
13 reviewing court affirmed the trial court’s dismissal of the case on the ground that the
14 plaintiff that inherited the suspended corporation’s lack of capacity had no intention
15 of paying the assignor’s taxes in order to revive its corporate status. (*Id.* at 312-313.)
16 Additionally, in *Thorner*, the court explained that where a company that lacks
17 capacity to sue transfers its legal claims to another, allowing the latter to prosecute
18 the transferred claims would “so obviously frustrate the purpose of the statute
19 [barring suit by the original claim holder] that we are unwilling to place such a
20 narrowly technical construction upon it.” (*Thorner*, *supra*, 180 Cal.App.2d at 93.)

21 The Trustee is in the same position as the plaintiff in *Cal-Western*. The claims
22 that he is attempting to assert belong to a suspended corporation. In the context of the
23 Debtor’s personal bankruptcy, it is difficult to conceive that the Trustee would
24 voluntarily pay the back taxes of a suspended corporation for which the Debtor is
25 presumably not personally liable. Unless the Trustee intends to do so, however, the
26 claims in the complaint cannot be asserted. Indeed, to advance such claims exposes
27 the Trustee and his counsel to potential imprisonment and disbarment. Revenue and
28

1 Taxation Code §19719 states that any person who attempts to exercise the powers,
2 rights and privileges of a suspended corporation (which would include prosecuting or
3 defending claims) may be punished "by a fine of not less than \$250 and not
4 exceeding \$1,000, or by imprisonment not exceeding one year." In 1998, §19719 was
5 amended to exclude counsel "retained by an insurer on behalf of a suspended
6 corporation." This exclusion, however, was not extended to counsel retained directly
7 by the suspended corporation, or an entity, other than an insurer, acting on its behalf.
8 Consequently, an attorney that represents a suspended corporation in a litigated
9 matter, but was not retained by an insurance company on behalf of the suspended
10 corporation, is in violation of Section 19719. An attorney, other than one retained by
11 an insurance company, who knowingly advances the legal interests of a suspended
12 corporation, potentially puts his or her license in jeopardy; "[i]t has always been
13 considered a sufficient cause for disbarment for an attorney and counselor ... to
14 encourage the commencement of proceedings which he knows, or has reason to
15 know, are illegal or unjust." *In re Stephens*, 77 Cal. 357, 19 P. 646, 647 (1888).

16 Because Hot Box could not assert the claims in the Bankruptcy on its own
17 behalf, the Debtor (in his capacity as sole shareholder of Hot Box) could not have
18 asserted them. Because the Debtor could not have asserted them, the Trustee cannot
19 assert them. See *Gough v. Titus (In re Christian & Porter Aluminum Co.)*, 584 F.2d
20 326, 331 (9th Cir.1978) (incapacity to sue or be sued of suspended corporations
extends to bankruptcy proceedings). The Complaint should therefore be dismissed for
21 failure to state a claim under Rule 12(b)(6).
22

23 **B. The Complaint fails to state facts sufficient to constitute a claim for
24 Breach of Fiduciary Duty**

25 Plaintiff alleges that "defendants C1R, Inc. and Robert Novinger breached their
26 fiduciary duties to Hot Box, the Debtor and his Estate by engaging in conduct that
27 constitutes gross negligence, reckless behavior, intentional misconduct, and knowing
28 violation of the law, including, without limitation, improperly (1) denying Hot Box

1 distributions from Rascal's payments to C1R Distribution totaling \$29,918.52
2 prepetition, and a minimum sum of \$5,775.27 postpetition; (2) failing to pay any
3 portion of Hot Box's capital account to Hot Box or the Debtor, which, as of
4 December 31, 2015, totaled \$157,283; 3) failing to repay any part of the Loans due to
5 Hot Box or the Debtor in the amount of \$242,178.88; and (4) engaging in actions
6 solely meant to benefit themselves as the majority and controlling owners of both
7 C1R Distribution and Rascal."

8 Notably, except for the conclusory, "the-defendant-unlawfully-harmed-me
9 accusations," these are the *exact same* allegations that Plaintiff alleges constitute a
10 breach of the operating agreement: "Defendants C1R, Inc. and/or Robert Novinger
11 breached the Operating Agreement by failing to pay Hot Box, prepetition, and now
12 the Debtor's estate, postpetition, what Hot Box and Debtor were entitled to be paid
13 for Rascal repayments on the Loans and by failing to pay any portion of Hot Box's
14 capital account to Hot Box or the Debtor, which as of December 31, 2015 totaled
15 \$157,283 and failing to pay any part of the Loans due to Hot Box or the Debtor in the
16 amount of \$242,178.88." (Complaint, ¶ 38).

17 The conduct alleged, however, does not constitute either a breach of fiduciary
18 duty, nor a breach of the Operating Agreement. To the contrary, the Operating
19 Agreement is explicit that Hot Box does not have any direct entitlement to the
20 amounts received from Rascal for repayments on the loan, does not have any right to
21 demand return of all or any part of its capital account, and does not have any
22 individual interest in the Loans, much less a right to demand immediate payment of
23 receivables for which C1R Distribution itself has not yet been paid.

24 The Operating Agreement provides:

25 1.2 Nature of Members' Interests. The interests of the Members
26 in the Company shall be personal property for all purposes.
27 Legal title to all Company assets shall be held in the name of
28 the Company. *Neither any Member nor a successor,
representative or assign of such Member, shall have any right,
title or interest in or to any Company property or the right to*

1 *partition any real property owned by the Company.* (Emphasis
2 added).

3 Former Corporations Code section 17300 similarly provides, "[a] member or
4 assignee has no interest in specific limited liability company property." See also
5 *PacLink Communications Internat., Inc. v. Superior Court*, 90 Cal.App.4th 958, 964
6 (2001) ("members of the LLC hold no direct ownership interest in the company's
7 assets").

8 The Loans – accounts receivable – are the property of the Company, as are
9 funds received in repayment of the Loans. By the plain language of the Operating
10 Agreement and governing law, neither Hot Box nor the Debtor has any right, title or
11 interest in or to such property. As such, C1R Distribution's alleged failure to remit
12 such funds to Hot Box or the Debtor does not constitute a breach of the Operating
13 Agreement.

14 To the extent that Plaintiff's claims for "unpaid distribution payments" are
15 based on the claim that C1R Distribution, LLC approved distributions to members
16 but did not pay them, they are simply incorrect. C1R Distribution's tax returns for
17 the relevant years show that no distributions were approved or made in any of the
18 years at issue. See Papile Decl., ¶ 7 (tax returns show that no membership
19 distributions were made to members of C1R Distribution in 2013, 2014, or 2015).

20 To the extent that Plaintiff's claims for "unpaid distribution payments" are
21 based on the theory that C1R Distribution, LLC *should have* approved distributions to
22 members, but did not, Plaintiff does not allege that C1R Distribution was in a
23 financial position to make such distributions, or that it made distributions in a manner
24 inconsistent with the operating agreement. In addition, Plaintiff would need to allege
25 facts sufficient to overcome the presumptions of the business judgment rule.

26 "The business judgment rule 'sets up a presumption that directors' decisions
27 are based on sound business judgment. This presumption can be rebutted only by a
28 factual showing of fraud, bad faith or gross overreaching.' (*Ritter & Ritter, Inc.*

1 *Pension and Profit Plan v. Churchill Condominium Assn.*, 166 Cal.App.4th 103, 123
2 (2008).) "But a plaintiff must allege sufficient facts to establish these exceptions. To
3 do so, more is needed than 'conclusory allegations of improper motives and conflict
4 of interest. Neither is it sufficient to generally allege the failure to conduct an active
5 investigation, in the absence of (1) allegations of facts which would reasonably call
6 for such an investigation, or (2) allegations of facts which would have been
7 discovered by a reasonable investigation and would have been material to the
8 questioned exercise of business judgment.' . . . 'Interference with the discretion of
9 directors is not warranted in doubtful cases.' " (*Berg & Berg Enterprises, LLC v.*
10 *Boyle*, 178 Cal.App.4th 1020, 1046 (2009).). Since it is not even clear from the
11 Complaint whether Plaintiff thinks C1R Distribution *did* make such distributions, and
12 withheld them from Hot Box (a position foreclosed by C1R Distribution's tax
13 returns) or *did not* make such distributions, but should have, it seems plain that
14 Plaintiff's factual allegations are not sufficient to rebut the presumption of the
15 business judgment rule with respect to unmade distributions.

16 With respect to capital accounts, the Operating Agreement further provides:

17 6.7 Withdrawal or Reduction of Contributions to Capital. No
18 Member shall have the right to withdraw any part of his capital
19 contribution or to receive any return on any portion of his
20 capital contribution, except as may be otherwise specifically
21 provided in this Agreement. Under circumstances involving a
22 return of any capital contribution, no Member shall have the
23 right to receive property other than cash. No Member shall have
24 priority over any other Member, either as to the return of capital
25 contributions or as to net income, net losses or distributions;
26 provided that this subsection shall not apply to loans that a
27 Member has made to the Company.

28 8.1 Withdrawal. Except as otherwise provided in this
29 Agreement, no Member shall at any time retire or withdraw
30 from the Company or withdraw any amount out of his capital
31 account. Any Member retiring or withdrawing in contravention
32 of this section shall indemnify, defend and hold harmless the
33 Company and all other Members (other than a Member who is,
34 at the time of such withdrawal, in default under this Agreement)
35 from and against any losses, expenses, judgments, fines,
36 settlements or damages suffered or incurred by the Company or
37 any such other Member arising out of or resulting from such
38 retirement or withdrawal.

1 The only circumstance “otherwise provided” in the Operating Agreement in
2 which a member is entitled to the return of his capital account is upon dissolution of
3 the company, and then only to the extent that such funds remain after payment of all
4 company obligations. Since the company has not been dissolved, Hot Box is not
5 entitled to the return of any portion of its capital account under the Operating
6 Agreement, and the alleged failure to return such capital account – or to turn over
7 other property of the LLC—cannot constitute a breach of fiduciary duty.

8 **C. The Complaint fails to state facts sufficient to constitute a claim for**
9 **Aiding and Abetting Breach of Fiduciary Duty**

10 Without an underlying breach of fiduciary duty, Plaintiffs' claim against
11 Novinger and Rascal Video, LLC for aiding and abetting that breach (Count Two)
12 should be dismissed. California has adopted the common law rule for subjecting a
13 defendant to liability for aiding and abetting a tort. ``Liability may ... be imposed on
14 one who aids and abets the commission of an intentional tort if the person (a) knows
15 the other's conduct constitutes a breach of duty and gives substantial assistance or
16 encouragement to the other to so act or (b) gives substantial assistance to the other in
17 accomplishing a tortious result and the person's own conduct, separately considered,
18 constitutes a breach of duty to the third person.' (*Saunders v. Superior Court*, 27 Cal.
19 App. 4th 832, 846, 33 Cal.Rptr.2d 438 (1994) ; Rest.2d Torts, § 876.)" (*Fiol v.*
20 *Doellstedt*, 50 Cal.App.4th 1318, 1325-1326, 58 Cal.Rptr.2d 308 (1996).) Where
21 Plaintiffs cannot state a claim for breach of fiduciary duty, they likewise cannot state
22 a claim for aiding and abetting that alleged breach. Because Plaintiffs' underlying
23 breach of fiduciary duty claim is defective for the reasons articulated above, see
24 Argument, Section III (B), supra, Plaintiffs' aiding and abetting breach of fiduciary
25 duty claim fails as well.

26 **D. The Complaint fails to state facts sufficient to constitute a claim for**
27 **Breach of Written Agreement**

28 Plaintiff asserts that C1R, Inc. and Novinger breached the Operating

1 Agreement by 1) “failing to pay Hot Box, prepetition, and now the Debtor’s estate,
2 postpetition, what Hot Box and Debtor were entitled to be paid for Rascal repayments
3 on the Loans and by failing to pay any portion of Hot Box’s capital account to Hot
4 Box or the Debtor, which as of December 31, 2015 totaled \$157,283 and failing to
5 pay any part of the Loans due to Hot Box or the Debtor in the amount of
6 \$242,178.88.” Plaintiff’s claim for breach of contract fails because neither Hot Box
7 nor the Debtor is entitled to be paid any portion of “Rascal repayments on the Loans,”
8 Hot Box’s capital account, or the loans themselves.

9 In a case involving the interpretation of a contract under California law,
10 dismissal is appropriate where “the court considers the contract language and the
11 evidence the parties have presented and concludes that the language is reasonably
12 susceptible to only one interpretation.” *Skilstaf, Inc. v. CVS Caremark Corp.*, 669
13 F.3d 1005, 1017 (9th Cir. 2012). Where the court reaches such a conclusion, it need
14 not afford plaintiff any “additional opportunities to find or present extrinsic evidence”
15 and may dismiss the complaint on a motion to dismiss. *Id.*

16 When the language in a contract is clear and explicit, as it is here, the Court
17 must give it effect to honor the intent of the parties. See *AIU Ins. Co. v. Superior*
18 *Court*, 51 Cal. 3d 807, 821-22 (1990) (“[T]he mutual intention of the parties at the
19 time the contract is formed governs interpretation. Such intent is to be inferred, if
20 possible, solely from the written provisions of the contract.”); Cal. Civ. Code § 1636
21 (“A contract must be so interpreted as to give effect to the mutual intention of the
22 parties as it existed at the time of contracting”); Cal. Civ. Code § 1638 (“The
23 language of a contract is to govern its interpretation, if the language is clear and
24 explicit, and does not involve an absurdity.”); Cal. Civ. Code § 1639 (“When a
25 contract is reduced to writing, the intention of the parties is to be ascertained from the
26 writing alone, if possible. . . .”).

27 As set forth in Section III (B), *supra*, the plain language of the operating
28 agreement precludes Plaintiff’s breach of contract claims. The Managers of C1R

1 Distribution did not elect to distribute cash to members in 2013, 2014 or 2015, and
2 even a cursory review of its tax returns for those years reveals that it was not in a
3 position to do so. Neither Hot Box nor any other member has a right to the return of
4 its capital account, or to distribution of company funds (whether received on account
5 of the Loans or otherwise), or possession of company assets (much less immediate
6 possession of hundreds of thousands of dollars that C1R Distribution has not received
7 and may not receive. The Plaintiff cannot bring a claim for breach of an agreement
8 based on conduct expressly permitted by that agreement, and Plaintiff's claim for
9 breach of written agreement should be dismissed.

10 **E. The Complaint fails to state facts sufficient to constitute a claim for
11 Conversion**

12 "Conversion is the wrongful exercise of dominion over personal property of
13 another." (5 Witkin, *Summary of Cal. Law* (10th ed. 2005), Torts, § 699, p. 1023.)
14 Ordinarily, a generalized claim for money is not considered a usual subject of
15 conversion, because a specific and identifiable sum must be involved. (*Vu v.*
16 *California Commerce Club, Inc.*, 58 Cal.App.4th 229, 235 (1997); 5 Witkin,
17 *Summary of Cal. Law*, supra, Torts, § 703, pp. 1026-1027.) If a "plaintiff neither has
18 title to the property alleged to have been converted, nor possession thereof, he cannot
19 maintain an action for conversion." (*Moore v. Regents of University of California*, 51
20 Cal.3d 120, 136 (1990) (*Moore*), cited in *Fischer v. Machado*, supra, 50 Cal.App.4th
21 1069, 1072 (1996).)

22 To the extent that Plaintiff's claims for "unpaid distribution payments" are
23 based on the claim that C1R Distribution, LLC approved distributions to members
24 but did not pay them, they are simply incorrect. C1R Distribution's tax returns for
25 the relevant years show that no distributions were approved or made in any of the
26 years at issue. See Papile Decl., ¶ 7 (tax returns show that no membership
27 distributions were made to members of C1R Distribution in 2013, 2014, or 2015).

28 To the extent that Plaintiff's claims for "unpaid distribution payments" are

1 based on the theory that C1R Distribution, LLC *should have* approved distributions to
2 members, but did not, Plaintiff quite plainly cannot truthfully allege that it had title
3 to, or possession of, such property, and cannot maintain an action for conversion
4 thereof.

5 To the extent that Plaintiff's conversion claim is based on Plaintiff's "right to
6 possess... the approximately \$157,283 from Hot Box's capital account," Plaintiff's
7 claim is barred by the plain language of the Operating Agreement, which expressly
8 provides that Hot Box does *not* have any such right:

9 6.7 Withdrawal or Reduction of Contributions to Capital. No
10 Member shall have the right to withdraw any part of his capital
11 contribution or to receive any return on any portion of his
12 capital contribution, except as may be otherwise specifically
13 provided in this Agreement. Under circumstances involving a
14 return of any capital contribution, no Member shall have the
right to receive property other than cash. No Member shall have
priority over any other Member, either as to the return of capital
contributions or as to net income, net losses or distributions;
provided that this subsection shall not apply to loans that a
Member has made to the Company.

15
16 8.1 Withdrawal. Except as otherwise provided in this
17 Agreement, no Member shall at any time retire or withdraw
18 from the Company or withdraw any amount out of his capital
19 account. Any Member retiring or withdrawing in contravention
20 of this section shall indemnify, defend and hold harmless the
21 Company and all other Members (other than a Member who is,
at the time of such withdrawal, in default under this Agreement)
from and against any losses, expenses, judgments, fines,
settlements or damages suffered or incurred by the Company or
any such other Member arising out of or resulting from such
retirement or withdrawal.

22 (Complaint, Ex. C, §§6.7, 8.1) (D.I. 4).

23 Moreover, Plaintiff's claim appears to rest on a misunderstanding of the nature
24 of a "capital account," which cannot be converted because it is not "personal
25 property" but a bookkeeping function used to track members' contributions and
26 respective shares of profits and losses. (See *id.* at §6.2) ("The Company shall
27 maintain a separate capital account for each Member pursuant to the principles of this
28 section and applicable Treasury Regulations. The initial capital account of each

1 member, which shall be the Member's initial capital contribution, shall be increased
2 by the amount of such Member's subsequent capital contributions and by such
3 Member's allocable share of Company Income and Net Income as hereinafter
4 provided, and each Member's capital account shall be decreased by the amount of
5 cash distributed to the Member by the Company and by such Member's allocable
6 share of Loss and Net Loss as hereinafter provided.”)

7 Pursuant to the operating agreement, the assets and liabilities which are tracked
8 by members' capital accounts are the property of the LLC, not of the individual
9 members:

10 1.2 Nature of Members' Interests. The interests of the Members
11 in the Company shall be personal property for all purposes.
12 Legal title to all Company assets shall be held in the name of
13 the Company. **Neither any Member nor a successor,
representative or assign of such Member, shall have any
right, title or interest in or to any Company property or the
right to partition any real property owned by the Company.**
14 (Emphasis added).

15 (Complaint, Ex. C, §1.2) (D.I. 4).

16 Former Corporations Code section 17300 similarly provides, "[a] member or
17 assignee has no interest in specific limited liability company property." See also
18 *PacLink*, 90 Cal. App. 4th at 964 ("members of the LLC hold no direct ownership
19 interest in the company's assets.") As such, neither the Debtor nor Hot Box can claim
20 a right of possession of *specific* property of the LLC, and the conversion claim fails.

21 Finally, the claim for conversion makes a conclusory allegation that *all*
22 Defendants "interfered with the Property by taking possession of the Property,
23 preventing the Plaintiff from having access to the Property, and/or refusing to return
24 the Property." If defendants *other* than C1R Distribution took possession of the
25 Property, though, the claim for conversion fails because such conduct would damage
26 the corporate entity as a whole, and would need to be asserted as a derivative claim.
27 A claim is derivative if its gravamen "is injury to the corporation, or to the whole
28 body of its stock and property without any severance or distribution among individual

1 holders, or it seeks to recover assets for the corporation or to prevent the dissipation
2 of its assets.” (*Jones v. H. F. Ahmanson & Co.*, 1 Cal. 3d 93, 106-107 (1969).)
3 Derivative claims include claims of company mismanagement and improper selling
4 and purchasing of company assets. (*Avikian v. WTC Financial Corp.*, 98 Cal.App.4th
5 1108, 1115-1116 (2002).) Derivative claims also include claims for the fraudulent
6 transfer of company assets without compensation to the company. (*PacLink*, 90
7 Cal.App.4th at 964.) These claims are derivative because members of a limited
8 liability company have no direct ownership interest in the company's assets. The
9 members, therefore, cannot be directly injured when the company is deprived of
10 assets. Instead, their injury is essentially a diminution in the value of their interest in
11 the company due to the company's loss of assets and is incidental to the injury
12 suffered by the company.

13 Plaintiff cannot establish that any defendant applied an identifiable sum, to
14 which Hot Box was clearly entitled, for such defendant's own use. All property at
15 issue belonged to the LLC, which administered them in accordance with the
16 operating agreement. As such, Plaintiff's claim for conversion fails.

17 **F. The Complaint fails to state facts sufficient to constitute a claim for
18 Turnover and Accounting**

19 Plaintiff alleges that “the distributions due to Hot Box in the amount of
20 \$29,918.52, prepetition, and a minimum sum of \$5,775.27, postpetition (collectively
21 the “Distributions”)...constitutes property of the estate for which the Debtor has a
22 legal or equitable interest as of the commencement of his bankruptcy proceeding.”
23 (Complaint ¶ 49). As set forth above, however, and as evidenced by C1R
24 Distribution's tax returns, no other members received distributions, and there is no
25 basis whatsoever for the claim that such distributions are “due” to Hot Box. The
26 Trustee's position appears to be based on the belief that there is some requirement
27 that any money received by C1R Distribution be distributed, dollar for dollar, among
28 the LLC members without regard for payment of C1R Distribution's debts. This is

1 not permitted by the operating agreement or the law. The “distributions” are not
2 properly subject to a turnover order because no distributions to members were
3 authorized or made and there is no evidence to suggest that C1R Distribution is in
4 possession of distributable cash sufficient to make the distributions Trustee demands.

5 Plaintiff further alleges that “Hot Box’s capital account, which as of December
6 31, 2015, totaled \$157,283 (“Capital Account”) constitutes property of the estate for
7 which the Debtor has a legal or equitable interest as of the commencement of his
8 bankruptcy proceeding” (Id.). Again, Plaintiff misconstrues the nature of a capital
9 account. Under the Beverly-Killea Limited Liability Company Act (which was in
10 effect from the formation of C1R Distribution through 2014), “capital account”
11 means . . . the amount of the capital interest of a member in the limited liability
12 company consisting of that member’s original contribution, as (1) increased by any
13 additional contributions and by that member’s share of the limited liability company’s
14 profits, and (2) decreased by any distribution to that member and by that member’s
15 share of the limited liability company’s losses [former] Corporations Code Section
16 17001(d). Since contributions can consist of property other than money and services,
17 *id* at 17001(g), a capital account is not a cash account, nor is there any requirement
18 that the initial capitalization of a company be maintained rather than spent in
19 establishing the company. As such, the value of Hot Box’s capital account is not itself
20 an asset that could be turned over. Rather, it represents, broadly speaking, a
21 collection of bookkeeping entries that reflect the proportion of Hot Box’s ownership
22 of C1R Distribution’s assets – which include the Loans and the money received in
23 payment on the Loans. (*See id*; Complaint Ex. C §§ 6.1-6.7). By claiming
24 entitlement to the Distributions, plus the capital account, plus the Loans, the Trustee
25 is asking for the same dollar three different ways. Conceptually, the members
26 contributed capital, which funds were used to operate the business, which eventually
27 resulted in the business owning the assets that were then sold in exchange for the
28 Loans, which are repaid over time. The capital account cannot be turned over because

1 it is not, itself, “property.”

2 In any event, Hot Box is not entitled to return of its capital account under the
3 operating agreement, nor to any portion thereof. The only property to which the
4 Trustee is entitled is Debtor’s ownership interest in Hot Box, which is already in the
5 Trustee’s possession. The mandatory method for valuing that interest upon an
6 involuntary transfer – such as the transfer to Trustee – is set forth in Sections 4.2-4.4
7 of the operating agreement.

8 With respect to the Trustee’s claim for an accounting, the Trustee is in
9 possession of C1R Distribution’s tax returns (as evidence by their being cited
10 throughout the Complaint). No accounting is needed to determine “how money from
11 Rascal was distributed to the other members,” as the tax returns show that none was.
12 No accounting is needed to determine the status of Hot Box’s capital account, the
13 amount of which is reported every year on Hot Box’s Schedule K-1. No accounting
14 is needed to determine “all legal and equitable interests of the Debtor and Hot Box in
15 C1R Distributions” – the Debtor has no such interest, and, as far as defendants are
16 aware, there is no dispute that Hot Box’s twenty percent interest is now an economic
17 interest held by the Trustee as part of the bankruptcy estate. (See Complaint Ex. C, §
18 4.5) (Unless and until admitted as a Member of the Company, involuntary transferee
19 holds only economic interest.)

20 CONCLUSION

21 The Complaint appears to reflect a belief that Hot Box occupies a privileged
22 position with respect to the other members of C1R Distribution and C1R
23 Distribution’s creditors, such that Hot Box is entitled to claim priority distributions of
24 revenue and capital, and demand the partition and distribution of company assets,
25 without regard to the Operating Agreement, the law, or the solvency of C1R
26 Distribution. The Trustee fails to articulate any facts that would support such an
27 astonishing finding, though, and the facts that are alleged, if stripped of their
28 “defendants are bad” rhetoric, amount to little more than a gripe that C1R

1 Distribution does not have as much money as the Trustee might wish. This is not
2 sufficient to support the claims alleged, and, given Hot Box's suspension, is
3 improper. The Complaint should be dismissed with prejudice.

4

5 Dated: May 25, 2017

Respectfully submitted,

6 **LAW OFFICE OF S. CHRISTOPHER WINTER**

7 By: 

8
9 S. Christopher Winter
10 Attorney for Defendants
11 C1R DISTRIBUTION, LLC,
12 RASCAL VIDEO, LLC, C1R, INC.,
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